RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

August 26, 1987 **LETTER 972**

Aug 14 DJIA 2685.43; PTI 2721; A-D Ratio -4.12
Aug 21 DJIA 2709.50; PTI 2737; A-D Ratio -4.15

THE PICTURE: In a later section of this Letter I include a piece on the Dow and its 1982-87 exponential rise. Because the Dow during 1987 has been in the vertical phase of a massive exponential rise, I feel more than ever that we must rely on the "fail-safe" system that I described earlier this year. This system demands that we assume a "show me" stance towards the stock market.

How does a show-me stance work? It's a stance in which we no longer take the primary trend for granted. *We insist, after each sell-off, that the bull market prove itself.* And how does a bull market prove itself? It does so when the two D-J Averages, following any decline or correction, rally back to new bull market highs.

If you remember, for years I said that our stance was "to give the bull market every benefit of the doubt." If there was a decline, if there was a correction, I said, "Fine, let the market correct, but this is still a bull market, and in due time the Averages and the majority of stocks will advance to new bull market highs." That was our stubbornly bullish attitude, and it worked. Following each decline the market did indeed advance to new highs.

Then in 1987 the bull market became overvalued, very overvalued. At that time I stated that I was changing our stance from "giving the bull market every benefit of the doubt" to *making the bull market prove itself.* This is the stance I continue to advocate now.

With values as inflated as they are today, I feel that the market is constantly treading on thin ice. Therefore, prudence dictates that we treat this market with the greatest respect, and that means demanding that the bull market prove itself following each sell-off.

So let's bring the market situation up to date. An interesting picture is developing, a picture which has probably been hidden by the sheer power of the Dow and the major averages.

Consider this: The D-J Utility Average topped out on January 22 at 227.83. The advance-decline ratio topped out on March 25 at a value of minus 3.12 (see page 2 chart). Despite this, the other Averages have continued their explosive climbs. On August 21 the Industrials closed at a record high of 2709.50. The Transports failed to confirm.

So as of this writing we have clear tops in the Utility Average and the A-D ratio with a peak recorded in the Transports on August 14. Is this action telling us that the market is losing steam? Is the upside momentum fading? We obviously can't know yet, but from a near-term standpoint the key place to watch is 1101.16 on the Transportation Average. A bettering of that level would suggest still higher prices while a stubborn refusal by Transports to rise above 1101.16 could be the signal for a top of some significance.

If subscribers think they detect a growing sense of caution in my writing, they are correct. As this bull market continues to set records for new highs (and for overvaluation) I grow more cautious. I've been through too many bull and bear cycles to think or act otherwise. Furthermore, all the current popular theories about why this market must go higher and why the bull will last until 1989 only make me more nervous.I know from experience that bull markets tend to top out when the "experts" are putting the next trouble a year or a few years away.

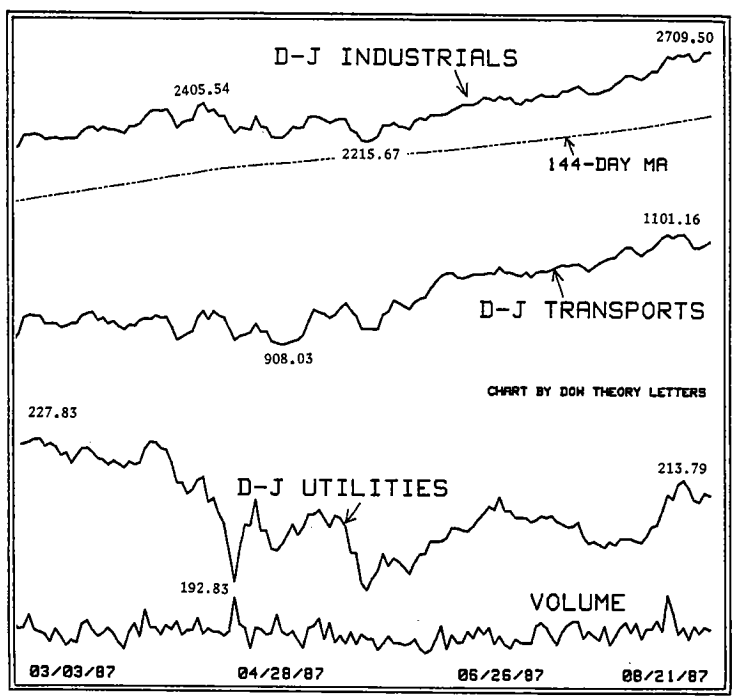
PTI: Despite my caution the Primary Trend Index (PTI) has continued to push to new bull market highs — as it has been doing ever since the 1984 lows. As veteran readers know, it is our policy always to stay on the right side of the PTI, and for years the right side of the PTI has been the bull side. On no single day since September 1984 has the PTI been below its 89-day moving average.

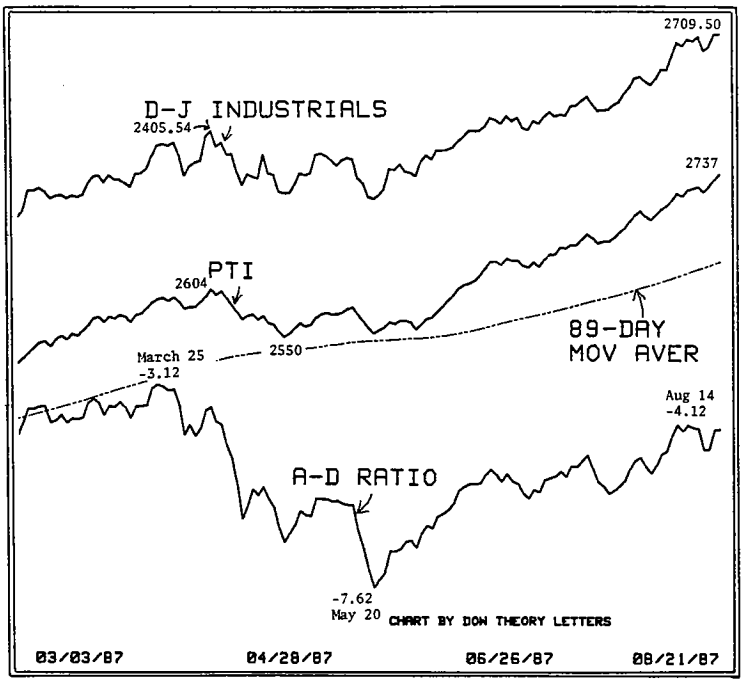
The action of the 1987 market has me pondering a number of things. For one, I have always used the advance-decline ratio as a proxy for the primary trend of the majority of stocks on the NYSE. But the fact is that the A-D ratio topped out last March. Did this mean that the primary trend of the market turned down in March? Hardly, but in all fairness to the A-D ratio's accuracy and usefulness, the majority of stocks on the NYSE have been laggards when compared with the dramatic advancing action of the blue-chip issues.

However, as a true indicator of the direction of the primary trend of the market, I feel the performance of my own PTI has been more accurate and more helpful than the A-D ratio. The fact is that the

PTI has led the way up in 1987 even while the A-D ratio was lagging (and it's still lagging). Thus being "on the right side of the PTI" has been a money-maker during 1987 while being on the right side of the lagging A-D ratio has led to a good deal of frustration and little profit.

One major advantage of the PTI over the A-D ratio is the A-D ratio is computed and watched by almost every analyst on Wall Street, while the PTI is computed and watched only by Richard Russell.





Back in the late-1960s when I first began experimenting with the PTI I did so because I wanted a market gauge which could not be followed by every other analyst. I felt with the rise of technical analysis that some day there would be *too many market analysts looking at the same items, and that one of those items would be the A-D ratio.*

That, in short, is the reason that I felt the need for a barometer that would be exclusively mine -- a barometer that by its construction had to lead or at least move coincident with the primary trend of the market. The PTI was the result, and this device has been instrumental in keeping my subscribers and me on the right side of the market ever since I started using it (and I might add that there were times when I differed with the "messages" provided by my own PTI. In every case, the PTI was right and I was wrong.).

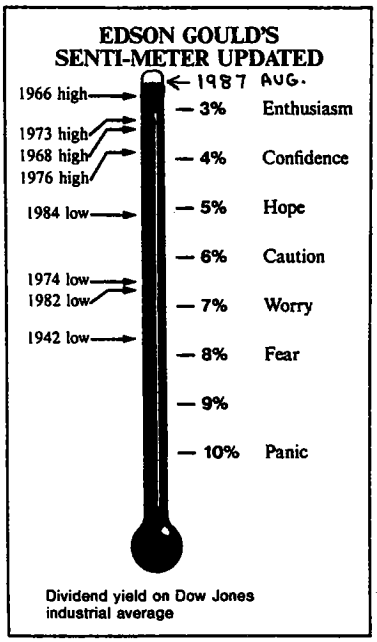
So much for market action (which has remained undeniably bullish since late-1974). Now I feel it might prove constructive to review a bit of history. We're in a primary bull market that began in December 1974 at 577.60 on the Dow. So far the great bull market has advanced the Dow 360% from its 1974 low, which makes this bull market one of the greatest in Wall Street annals. In comparison the 1921-29 bull market advanced the Dow 495%, and the 1932-37 bull market advanced the Dow 373%.

We have also seen the current bull market go through a major yield cycle. In 1974 the yield on the Dow was 6.5%, a juicy yield by any reckoning. Here in 1987 the yield on the Dow has dropped to 2.52%, the lowest yield on record. In 1974 the stock market represented a great value. In 1987 the stock market is as overvalued as it has been any time in history.

So what do we, as investors, do about it? I've been writing these reports for almost 30 years, and I've learned that if one is to be successful in investing, one must develop a method of operation, a procedure, and it has to be a procedure that has withstood the test of time. There is only one stock market procedure that I have ever seen (and I have studied hundreds of them) that works consistently. That procedure is to *buy stocks when they are great values and sell stocks when they are slim values.* Baruch knew this, the Rothschilds knew this, Joseph Kennedy knew this, Warren Buffet knows this, and you and I had better know this.

Stocks can sink well below known values (at or near a bear market bottom) and stocks can rise far above known values (at or near a bull market top). There's an interesting connection between market values and market sentiment. For instance, we know that it is gloomy market sentiment (i.e., fear) that drives stocks below known values in a bear market. And we also know that it is frothy optimism (greed) that drives stocks above known values in a bull market.

But what about actual valuation levels? If you follow the yield cycles of this century you will note that the stock market has usually topped out when the yield on the Dow was around 3% or lower. On the other hand, the stock market has usually bottomed out when the yield on the Dow was around 6% or higher.



The late, great market analyst, Edson Gould, used a little device which he termed the "Senti-Meter" to show how the yield level on the Dow dovetailed with prevailing stock market sentiment. I have updated Gould's Senti-meter here, and by Gould's standards the market has now risen beyond "enthusiasm." I guess Gould would have termed today's market level as "super-enthusiasm" or "bullish hysteria" or something like that.

All of which again brings up the question, "What do we do now?" My best answer is the one I've repeated in recent Letters, and that is to institute a policy of gradually taking profits as this bull market works higher. Today the market is in the "super-enthusiasm" zone, volume is huge, many stocks are going up as much in a day as they will provide in dividends in the next two to five years.

Each big bull market seems ultimately to develop its own "folk lore" or rationale for being. The rationale for this bull market appears to be based on the thesis that "This is a global bull market, and US stocks are cheap compared with other markets, particularly the Japanese stock market. Since Japan is swimming in liquidity and US stocks and bonds are cheap in terms of Japanese securities, the US is enjoying literally a "topless" bull market. Anyway, as I piece it together that's the folk-rationale for the 1987 bull market advance, and it will certainly do until a better rationale comes along.

YIELD UPDATE: The latest figures show the Dow at a yield of 2.52%, thereby selling at an incredible 39.7 times dividends. The S&P 400 Industrials are at a 2.25% yield, thereby selling at a record-breaking 4.44 times dividends. For reference purposes, at the last nine bull market tops the average price/dividend yield for the Dow was 31.1.

INVESTMENT POSITION: I'm putting a new bull in this box. The new bull is (significantly) a lot wilder looking. But he is still missing one horn, signifying that despite his ferocious demeanor, he lacks the strength of underlying values. And don't belittle values -- values constitute the basic fundamentals beneath every bull market.

I probably get asked 10 times a day, "Russell, how high do you think this market is going?" And my answer is always, "No one, no one on the face of this green earth, knows." This invariably disappoints or even angers the askers, but let's be honest, what these people are really asking is "How far can an overvalued bull market climb before it topples over?" And the answer is that it can climb until it becomes exhausted, and the exact exhaustion point in a market like this is unknowable.

What we do know is that this market has broken all records for the duration of an uncorrected advance and for the extent of an uncorrected advance. This bull market has also broken records for overvaluation. We also know that each bull market, when it ends, has its own cute way of costing stockholders big bucks.

So what's the solution? The intelligent solution, it seems to me, is to gradually give the market back some of our choice blue-chips -- to give them back some of those golden beauties that we have made so much money with such as Merck, Woolworth, Raychem, Exxon, J.P. Morgan, Proctor, duPont, Royal Dutch, Phillip Morris, Primerica (American Can when we bought it) and so forth.

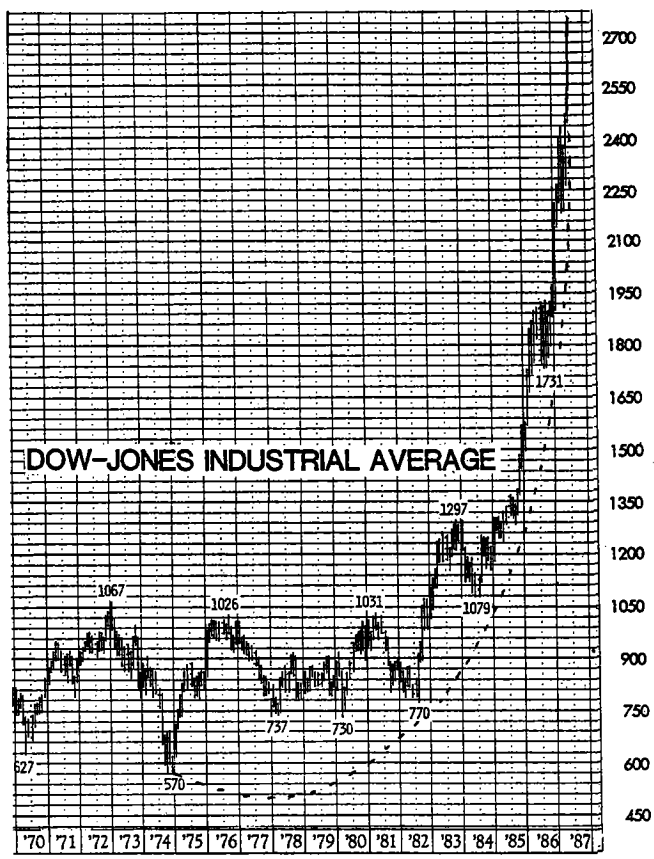
The figure I gave recently was about 66%. In other words, I thought you should own about two-thirds of the amount of stock you owned at the beginning of 1987. I am now reducing that percentage to 60%. In other words, cut down your stock portfolio to 60% of the amount of blue-chips you owned as of January 1 of this year.

"But won't that cut down on the profits I'll show if this market continues higher?" you complain.And my answer is, "Sure it will. But it will also provide you with half a leg out the door if this market starts toppling over. Besides, taking some profits is a fine exercise in holding your greed in check. And greed is a copious commodity as the bull market works higher."

PARABOLIC: In the last Letter I again presented a study of the exponential rise, often termed a parabolic curve. I explained that an exponential rise takes the form of an ever-steepening upward curve, and that in the final phase of the exponential rise the price action goes vertical -- it goes straight up!

Because the Dow has been in an exponential rise since 1982 and since 1986 in the VERTICAL STAGE of that rise, I felt that an update on the chart was warranted.

Note that the Dow broke out of its 17-year top-range (the top of the range was just above 1000) in late-1983. The rise carried to an intra–day Dow 1297. A consolidation-correction took the Dow down to an intra-day 1079 in July 1984.



Next came a mighty advance from 1079 to 1920. (1984 to 1986). Another consolidation-correction occupied most of the year 1986. A new burst carried the Dow (again almost vertically) to above 2400 in early 1987. Here again the Dow dropped into a consolidation–correction, followed by the most recent vertical explosion.

On August 21 the Dow closed at an historic high of 2709.50 (intra-day high was 2735.49). At this point the market appears a bit tired with the Transportation Average (despite sharply lower oil prices) looking somewhat toppy.

The Dow gives the appearance of a Roman Candle on the accompanying chart, and it remains to be seen at what level the rocket burns out. But no matter what happens, this chart will go down in history as one of the great examples of a market in the throes of "buying panic hysteria."

BONDS: I don't know what the average age of my subscribers is, but I would guess that I have around three thousand subscribers under the age of 30 (I can pretty much tell by letters I receive here).

I've written this piece on bonds for a number of reasons. (1) I have, over the years, written more about the wonders of compounding your way to wealth than probably any other advisor, and I want to continue in this vein, (2) Bonds are an ideal vehicle for compounding your money. (3) Compounding is a particularly advantageous way for young people to invest, since young people have time on their side, and in compounding, time is money. (4) Very few people understand the power of compounding for wealth building purposes, and even fewer understand the concept of compounding via systematic purchase of bonds.

The single surest road to riches is via compounding and reinvesting. I've gone over this many times, but let me give you a few examples. If you invest $5,000 each year at a non-taxable (muni) rate of 7%, in 10 years you will have the sum of $69,080. In 20 years you will have $204,975. If you invest $5,000 each year at a non-taxable rate of 9%, in 10 years you will have $75,960. In 20 years you will have $255,800. Of course, in both cases one must assume that you can reinvest the income at the same rates (i.e., 7% in the first case and 9% in the second).

Those figures are interesting, but I doubt if they will surprise many veteran subscribers. However, here is something that very, very few people know or understand. Let's take two cases. One investor buys a $5,000 bond every year for 20 years, but he is doing this in an environment where interest rates are generally heading down. The second fellow buys a $5,000 bond every year in an era where interest rates are generally heading up.

Which of the two investors is going to come out ahead in the end? The answer is the second investor, the person who is buying into an era of rising interest rates (in other words, he's buying year after year into a bear market in bonds, but he's still going to come out ahead).

"How is this possible?" you ask. It works because in compounding you are (in due time) compounding the interest on your interest, and (again, in time) the interest on the interest will be more important than the principle. In other words, when you buy a $5,000 bond, within a given amount of time the *reinvestment of the interest on that bond will be more important than the original $5,000.*

How has this super-important principle escaped the eyes and thoughts of most market analysts? The reason is that most anlysts today do not think in terms of 10 or 20 years, they think in terms of current return on investment. In other words, they think in terms of how their performance is going to look today rather than in terms of how their performance is going to look in 10 or 20 years.

Example: If a portfolio manager buys $10 million worth of bonds during a period of rising interest rates, a year from purchase time he may have to show those bonds as being worth only $9.8 million. That's a decline in net assets, and it's a no-no in today's competitive environment. It doesn't help for the manager to say, "Look, I'm reinvesting the interest I get from these bonds at higher rates as part of a long-term program, and by the year 2010 we're going to be way ahead." The portfolio manager can't do that, because he sells his fund on the basis of his current performance. He's in a competitive, "how are you doing NOW?" business.

No, the portfolio manager would rather buy those $10 million of bonds in an era of declining interest rates and show that in the following year the $10 million of bonds are worth $10.3 million at market (even though he must reinvest his bond interest at lower and lower rates as the bond bull market continues).

Remember this: In both cases the bonds will mature at par (1,000), so that in a bond bear market the buyer who holds his bond to maturity will get his full 1,000 back and in a bond bull market the bond buyer still gets no more than his 1,000 back at maturity.

If you want to make your fortune by periodically buying bonds, however, you must remember two things: (1) You must continue to reinvest at prevailing rates, regardless of the trend of bonds. (2) You must buy good-quality bonds, bonds that will not default, and that means investment grade bonds rated A or better (preferably AA-rated bonds). After all, it does no good to compound if you are going to buy low-grade bonds and are in danger of losing your principle before the bonds mature.

So again let's ask the question, "Who does well in a long-term bear market in bonds?" Answer: The investor who buys top-quality bonds on a systematic basis and then reinvests the interest on those bonds as the interest comes in.

THOUGHTS: The Christian Science Monitor (a great daily newspaper) recently ran a stunning series of articles entitled, "Children of Darkness." The series is about child prostitution in the Philippines, it's about 6-year-old children working 10 hours a day in the factories of India, it's about millions of children begging, working, or selling their bodies in the streets of Brazil, Vietnam, Thailand, Peru, Chile, and Argentina.

I guess the article hit me hard. It hit me because no matter what I do or what I see or how the world turns, I still feel to some extent (sad to say) like a child of the Great Depression. I know how poverty and fear scars the mind of a child. I grew up when times were hard. My father was a civil engineer and we actually lived pretty well during the Depression. But during those years I absorbed some of my father's fears of losing his job or of getting sick or of seeing real estate go bankrupt. I also picked up the fears of the men and women I saw in the streets of New York. Children get scared easily, and they get scarred easily.

Over the years I've worked hard at neutralizing those fears. I guess I've learned what the great teacher said in the gospels: "Ask and you shall receive." He also told us to observe the lillies of the field. Those fragile flowers survive and blossom for no other reason than that they are God's creations. I also know that when Moses led the Jews out of Egypt and when they faced starvation in the desert, manna fell from the skies, and Moses and the Jews survived. I am aware of the "law of abundance" which states that we will all get what we need.

But I also know that when Jesus took pity on hungry multitudes he fed them with bread and fish. But later he admonished his disciples, "Gather up the fragments that remain, that nothing be lost." Ah, that gets to me. You see I might as well admit that in these days of plenty, waste drives me up the wall. For instance, when my kids leave the lights on all over the house I yell at them, "Hey, turn those lights out, we don't have to support San Diego Gas & Electric single-handedly," and when I'm eating dinner at a salad bar, and I see some lady rise from the table, having left half her salad on the plate, it's all I can do to refrain from saying, "Miss, don't you feel guilty about taking all that good food and then leaving three-quarters of it for the garbage men!"

But what does it all have to do with the starving people and the children who are being worked to death and the children who roam like lost dogs on the streets of the big cities? Those are questions I'm working on. But to tell the truth, I've never been able to put it all together.

In a recent issue of Fortune magazine there appears an article on the new massive emphasis in America on making money. The article states that at every level, from law to medicine to Wall Street, the great American urge is to make money, money, and more money. Mergers, acquisitions, leveraged buy-outs, the new millionaires and billionaires, record prices for apartments in NYC and Boston and San Francisco, Mercedes and BMWs in every garage, Rolexes on every wrist -- it's the new order. No more hippies, no more college protesters, no more soul-searching, this is the era of big money, big cars, big buyouts, big egos, and big lawsuits.

In the July issue of Manhattan magazine (which is the new Yuppie's bible) there is a story by Louis Auchincloss. Auchincloss is a fine writer who has been writing about the upper classes for decades. He is also a successful lawyer (wills and estates) at the old-line firm of Hawkins, Delafield & Wood. In an interview Auchincloss says, "All you have to do is look at the statistics. The chances of marriage are 50% to divorce. . . . The lack of trust in marriage is mirrored in the new generation's business life. They don't have the loyalty of the Mafia. If you look around, you find the breakup of firms and organizations all the time. What are they breaking up about? They're always breaking up over a division of profits, a division of spoils. They're selfish and on the make. They don't have any team spirit. They don't even like each other. They 'll tell on each other right away. No, no, it's not a very attractive world."

Forbes creates an annual sensation with its listing of the richest Americans. Fortune lists its 500 biggest corporations and Business Week lists the biggest and the best. I just received an issue of US News & World Report, and on their front cover they blare, "Stock Market Killings" and inside they list the 100 individuals or families with the largest chunks of public corporations. Everywhere we look we see a new listing of the richest or the most powerful or those who have made the biggest killings. The new era of greed is upon us. It's here.

Meanwhile, fool that I am, I still worry about turning the lights out and wasting food. And I read the Christian Science Monitor article, and it says there are 3,000 children working as slaves in the jungle gold mines of Peru and 15,000 kids prowling the streets of Manila and 40,000 children working as prostitutes in Thailand and in the Mirzapuir district of India there are 100,000 kids working as semi-slaves making carpets for export.

I don't know what to make of it all. It's like the US deficits, it's like AIDS, it's like inflation in Brazil. It's beyond my comprehension. I keep thinking that there must be a meaning to it and maybe even an answer to it. I just haven't found the meaning or the answer yet.

NOTES & QUOTES: I don't know how many people in Washington know what gold is all about, but one who definitely does is new Fed chief Alan Greenspan. These two paragraphs are from a paper Greenspan wrote in 1966.

"In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value. If there were, the government would have to make its holding illegal, as was done in the case of gold. If everyone decided, for example, to convert all their bank deposits to silver or copper or any other goods, and thereafter declined to accept checks as payments for goods, bank deposits would lose their purchasing power and government-created bank credit would be

worthless as a claim on goods. The financial policy of the welfare state requires that there be no way for the owners of wealth to protect themselves.

"This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the 'hidden' confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism towards the gold standard."

After reading the above, you should understand a lot about Alan Greenspan. You will also know why I am a Greenspan fan. And if you think Greenspan is going to accept inflation as a way out of the US debt predicament, I'd say, "Forget it. He won't."

* *

Rocks Around the Clock: This year the Chicago Board of Trade started trading T-bond futures and options (in an extra session) from 6 to 9PM Mondays through Thursdays. Starting September 13 the CBOT will be trading gold and silver futures on a 24-hour basis. The Commodity Exchange in New York is thinking about the same thing in gold futures. For insomniacs, 1987 should be a picnic.

* *

Japanese bought $1 billion worth of US real estate in the years 1983 to '85. In '86 they boosted their US purchases to $6 billion, and this year it looks like $12 billion. Foreigners now own 46% of all commercial real estate in downtown LA, 39% in Houston, 32% in Minneapolis, 21% in NYC. Russell opinion: It's OK with me. If they've got the money, let 'em buy. If and when we stop borrowing and start producing, we'll reverse the trade flow, accumulate some cash, and buy it all back. Right?

* *

A few weeks ago a noted landscape architect was quoted in an LA Times piece about cities. The architect (Jere Stuart French) asked, "Are all cities getting worse? Is there a peak time for every city, after which it begins a long, irreversible decline?"

French thinks that almost all the major cities are past their prime. He thinks London's prime was in the 1800s before the Industrial Revolution. Paris' prime was around 1880 during the city's reconstruction at a time when France's great impressionist painters were in flower. Vienna's prime was in the early 1800s during the time of its great composers. New York during the Jazz Age of the 1920s, San Francisco in the 1950s, LA in 1939 during its golden age of architecture. Honolulu hit its peak in 1940. (Today "Honolulu is Miami Beach west.")

Are there any cities not declining? French thinks the possibilities are Tucson, Seattle, San Diego, Phoenix, and San Antonio. What are the destroyers of the cities? Uncontrolled population growth, sprawl, greedy developers, out-of-control traffic congestion, crime, smog. The author of the article states, "The only big cities that I haven't seen destroyed by the automobile are Moscow and Leningrad, and that's because not every Russian can afford to own a car."

Personally, I left NYC in 1961 because I saw it being destroyed. I grew up in NYC during the 1930s and '40s when you could park a car in front of your house and when you could take your girlfriend for a midnight stroll across Central Park without being mugged. I saw NYC fill up with cars, garbage, and people, and I left when it became more of a hassle and discomfort to live in the City than I thought it was worth.

I'm now seeing signs of the same slow destruction in San Diego -- cars, people, congested freeways, rising real estate prices. Personally, I don't have any answer to the problem of the destruction of the cities. Today the whole world is in the throes of a population boom. The obvious victims are its great cities from Cairo to Mexico City, from Miami to Rio (by the way, my own opinion of cities on the rise are the Canadian cities, with my choice being Vancouver, a city which reminds me of my beloved Manhattan during the '40s).

* *

Speaking of cities, the latest report on home prices shows some surprises including the fact that the median price of a home jumped 4.5% between 2nd quarter 1986 and 2nd quarter '87. Biggest boosts were Providence, RI, where the median price rose from $84,400 to $109,800 (up 30%). Hartford, Conn., up 23%, Wash., DC, up 17%. Detroit up 15%, Jacksonville, FL, NYC, and Philly all up 14%. Laggards include Baton Rouge down 7%, Houston down 6%, Omaha down 3%, Miami/Hialeah down 1.5%, Dallas/Ft. Worth down 3.8%.

* *

If state taxes are killing you, where do you move? The following states have no income taxes: Alaska, Florida, Nevada, S. Dakota, Texas, Washington, Wyoming. These three states tax unearned income but not earned income: Connecticut, New Hampshire, Tennessee.

* *

Two new books have been published about Mary Todd Lincoln, wife of the president ("Mary Todd Lincoln, A Biography" by Jean Baker and "The Trials of Mrs. Lincoln" by Samuel Schreiner). Next time you think you've got troubles consider the unbelievable bout of troubles experienced by Mrs. Lincoln. She was married to a brilliant but neurotic man who was assassinated while in office. She had four children. Eddie died of tuberculosis at 3. Willie at 11 died of typhoid. Tad at 18 died of pleurisy. . Bereft, sick, and grief-stricken, Mrs. Lincoln was left with her oldest son, Robert, with whom she had been at odds over financial matters. In May 1875 in Cook County she was declared insane and placed in a hospital for the insane by Robert who was embarrassed by his mother's behavior.

* *

Japan, since World War II, has been run by basically the same group, a group which discourages consumption, punishes personal indulgence, and thinks basically only of export and bringing hard currencies into Japan. Housing is sky-high in Japan (so high that mortgages of up to 70 years are not uncommon), driver's licenses cost $2000, food costs take up 50% of personal income, and personal savings take up over 20%. Japanese pay cash for almost everything since until recently there was no personal financing. In short, everything in Japan is still aimed at export and building Japanese currency reserves while at the same time discouraging consumerism. This is also one of the reasons why Japanese citizens, flush with cash, have poured their money into the Japanese stock market and pushed Japanese stocks to unbelievable levels of overvaluation.

GOLD: Here's a chart which I'm reprinting courtesy of the Silver & Gold Report (Bethel, CT 06801). It's a most interesting chart, and I feel it's worth some comments.

The first section of the chart starts during the Nixon years. Here we see the initial rise in a great gold bull market, a rise which began at a gold level just over 40. Toward the end of the Nixon reign actual physical gold began to leave the US at an alarming rate.

Nixon's solution was to close the gold window, which meant that foreigners could not call in any more US gold. At that time the US government's attitude was that gold was just "a barbaric relic" but nevertheless we'd better not lose any more of it. Then as Nixon (with Fed help) jazzed up the economy he announced to a startled world that he was "a Keynesian." Gold continued to climb. Next came Watergate, and with that political disaster the price of gold moved up to the 125 level.

Mid-1973 brought in President Ford, and with him a bit of relief on the political front. But a bear market was raging on Wall Street, and gold pushed to the 180 level. The bear market in stocks ended in late-1974. By the end of '75 the stock market was moving up strongly (a new bull market had started), and investors were feeling much better about Wall Street and the economy .

With the return of hope on Wall Street, gold sold off to around 150. Jimmy Carter entered the scene in 1976, and for a brief period the nation remained hopeful that Carter would prove to be the strong, innovative president they were looking for. America was in for a major disappointment. Carter turned out to be a well-meaning, ineffective, indecisive wimp. Inflation began picking up steam, and by 1978 it seemed that inflation was literally out of control. Prices went up, interest rates went up, and the precious metals markets responded with a roar. During that inflationary hysteria silver rose to $50 an ounce and gold to $850 an ounce. It was here that the Fed under Chairman Volcker put the clamps on the money markets as interest rates on T-bonds rocketed to the 15% area. But the money market vise was closing. The air was being squeezed out of the inflation balloon.

The year 1980 opened with spear-point tops in the metals --and then an historic tumble. Ronald Reagan was the new president and his promise was a balanced budget, lower taxes, a revitalized military, and a return to American greatness. Americans loved it, but the precious metals didn't. They headed down. Silver crashed with an incredible eleven "limit-down" days in a row. When the metals bear market finally ended, silver had lost 90% of its bull market (50) peak value and gold had sunk to the 300 level. A bear rally in gold carried it back to 510 in 1983, and then downside pressure came in again. By February 1985 gold was down to 284.25, having lost 66% of its peak (850) value.

Around 1985 investors began comparing the Reagan promises with the supply-side failures and the long series of busted budgets and horrendous deficits. The fact was that in a period of a few years the Reagan Administration (with the help of a wild-spending Congress) had more than doubled the federal debt. "Above two trillion" was the new debt number Americans were looking at -- with no relief in sight.

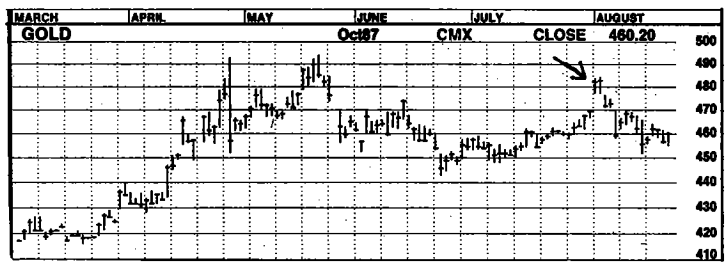
In the face of the debt and budget disasters, gold started up again. "How do you pay off $2.3 trillion?" people asked. The answer: "You don't" -- or "Oh yeah, you just wipe it off the books via inflation." By 1986 in the face of an emasculated Gramm-Rudman bill, gold was heading back over 400. By mid-1987 gold was over 450 and the 510 peak of 1983 loomed like a new target -- just over the horizon.

All of which brings us to the present and an opening piece from an article which appeared in the August 14 New York Times:

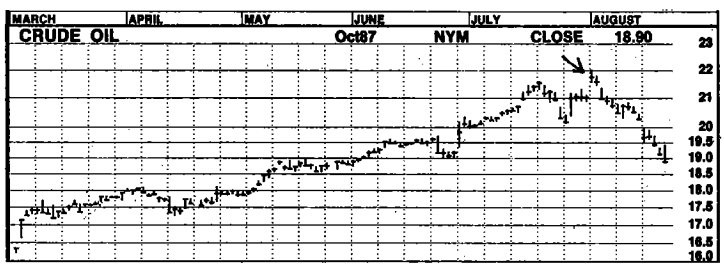
> **FEW groups of investors have been as estatic over the soaring stock market this year as the gold bugs, who normally view any positive economic news as a disaster. Have the investors in gloom and doom suddenly been converted into optimists? Hardly. Rather, the gold bugs view each record-breaking advance in stock prices as a step closer to the inevitable end of the bull market.**
>
> **When that happens, the gold bugs expect a mass flight of capital out of "paper stores of value" and into such tangible assets as precious metals.**
>
> **Some of this thinking has also gained adherents among institutional stock portfolio managers, who have increasingly been using gold futures as well as options on these contracts this year to hedge, or insure, against a market correction.**
>
> **Many metals market analysts say this is why gold, silver and platinum soared with the stock market in the first quarter; soured when equity prices meandered aimlessly in the second quarter, and then rebounded with the record advances of stocks during the current quarter.**

Is this the story? Is gold waiting in the wings, watching like a silent, stalking tiger for the ultimate toppling over of the great bull market? I do think that's one factor behind the slow but steady bull market in gold, and maybe it's the main factor. But as I have said before, "Ours not to reason why, ours but to buy and buy."

The daily chart of gold (Oct. futures) could be telling us that gold has now sunk into a trading range. Note the two upside days in the 478-84 range. Those two days (arrow) are sitting up there alone, *separated from the rest of the action by gaps*. This pattern is called an "island reversal," and it *usually signifies a top or at least a temporary top*. Therefore, I would expect gold to fluctuate between 445 and 470 over the foreseeable future. (Note: The 144-day moving average for gold is now 440.) However, I personally will continue my policy of systematically buying a fixed-dollar amount of gold bullion coins each month (Eagles, Krugerrands, Pandas, Maple Leaves).



Crude oil is particularly interesting now. Back in Letter 966 I included a study of post-panic price action, and I showed that the oil panic had taken crude from a price of 32 to just under 10. I stated that *the surest of all market actions was the automatic 50% recovery following a panic decline*, and for this reason I would expect oil to rise to around 21 prior to any further downside action. As you can see, October crude (futures) rose to 21, then popped for a brief moment to 22 before establishing an island reversal. Since then the direction of crude has been down. Last week spot crude broke under 18 for the first time since last June.



LATE NOTES: In all my years in this business I've never seen anything quite like it. Every day I read a few articles about "1987 and 1929" or "why this market is dangerous." Ironically, at the same time, the experts are saying that this market "has to go higher, because everyone else is bearish." It's as if contrary opinion has become the popular opinion. For that reason, I've become very wary of contrary opinion and widely advertised "bullish/bearish consensus."

I do know this. You don't buy stocks yielding 2.5% for income or investment purposes. You buy them "because the're going higher" or "because the Japanese will pay more for them next month." Consciously or unconsciouly, the greater fool thesis is king on Wall Street today.

NEXT MAILING: Sept. 9